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The Dimensions of the Shark Tank: The Appropriate Regulation of Payday Lending in South Carolina

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THE DIMENSIONS OF THE SHARK TANK: THE APPROPRIATE REGULATION OF PAYDAY LENDING IN SOUTH CAROLINA

I. INTRODUCTION

Payday lending presents a problematic double-edged sword. On one hand, arguably predatory lenders charge fees which, when aggregated, often result in very high annual percentage rates (APRs). On the other hand, countless, often unsophisticated consumers have few alternatives for short-term credit without these lenders. The dynamics of this market create opportunities for exploitation and abuse. When this practice is unregulated, lenders can structure transactions that take advantage of the less sophisticated consumers. Needless to say, the problem is complex, and efforts to address the issue have progressed in a variety of ways. A minority of states has determined that the best solution is to essentially ban the practice. Others, such as South Carolina, have attempted to regulate the industry and strike a balance between the needs of consumers and the potential for abuse. Unfortunately, no scheme is perfect, and state governments and regulatory agencies must vigilantly continue to monitor developments in the industry to ensure that consumers remain protected.

There is no clear solution or "right answer" to the problems inherent with payday lending. However, the most practical option is to craft a system that balances the two extremes (unregulated vs. abolished) by allowing the practice, but strictly regulating it to combat abuse. A demand for payday loans exists, and basic economics suggests that consumers would not demand a product that did not result in some benefit to them. Moreover, there are often legitimate needs for this type of credit; thus, not every payday loan is necessarily predatory. Completely outlawing the practice, therefore, would deprive consumers who legitimately need these loans from a desired service. Conversely, payday lenders should not be allowed free rein, where they can take advantage of unsophisticated consumers who do not comprehend the full consequences of the transactions.

The South Carolina General Assembly's recent enactments are a major step toward a balanced approach. However, because the effectiveness of these provisions remains uncertain, state entities as well as consumer watchdogs should continue observing the industry to ensure that borrowers are protected and that regulations are adequately enforced. In addition, the General Assembly should consider promulgating an enabling act to allow a state agency, such as the State Board of Financial Institutions, to issue regulations that could more easily address problems in a timely manner. Finally, South Carolina should consider a broader regulatory scheme that oversees all short-term loans (rather than solely payday loans) so that lenders cannot take advantage of loopholes in the South Carolina Code. By undertaking these strategies, South Carolina can secure a safer and fairer payday lending market for its citizens.

Part II of this Note introduces the structure of a typical payday loan and tracks the historical development of the practice. Part II also discusses behavioral economic theory, providing context for why these loans exist and describing some inherent problems in the structure of the payday lending market. Part III analyzes the various regulatory approaches governments have undertaken in relation to the industry, recognizing that neither an unregulated payday lending market nor an outright ban is desirable. Part IV examines the history of South Carolina's efforts to regulate the payday lending industry. Part V discusses why South Carolina should not let the industry operate in a laissez-faire environment, pointing out the economic inefficiencies of the unregulated practice and arguing for continued enforcement and oversight rather than a ban. Finally, Part VI provides recommendations for how South Carolina can oversee the payday lending industry in the future. Ultimately, a well-enforced regulatory scheme can create a level playing field where both borrowers and lenders benefit from the transaction.

II. THE BACKGROUND OF PAYDAY LENDING

A. *What is a Payday Loan?*

Betty Borrower is a typical American citizen living in the state of South Carolina. She is a single mother of three and works at a local retail store. Betty makes a modest hourly wage, and her earnings are usually enough to cover general expenses as they arise. However, last month one of Betty's children became ill with pneumonia and had to see a doctor twice. Because she does not have health insurance, Betty must pay for these visits out of pocket. Betty rides public transit to work and rents, rather than owns, her residence. Therefore, she is unable to utilize resources like a car title loan or a home equity line of credit. In addition, Betty's poor credit history means that her credit card limit is set at a ceiling of $200, and unfortunately she has no family members who are able to help cover her costs. How is Betty going to pay for these unexpected expenses? When a situation like this arises, a payday loan may become desirable.

Payday loans are easy to qualify for and a borrower can receive cash very quickly. In a typical state, a lender may only need "a driver's license, pay stub, bank statement, telephone bill, and checkbook" from the borrower to issue a loan.[1] If Betty presents a payday lender with these items, she can receive cash immediately, regardless of her credit history.[2] In a typical transaction, Betty would state the amount of cash needed and then give the lender a postdated check for that amount plus whatever fee the lender charges (either a flat dollar amount or a percentage of the principal).[3] At the end of the loan's term, typically around two weeks, the lender would cash the check and the transaction would be complete.[4] In an ideal world, Betty would have enough resources to cover repayment of the loan plus the fee. However, like many consumers, she may be unable to repay the entire balance when it comes due.

Complications arise when a borrower cannot repay a payday loan because many lenders structure each payday loan such that it must be paid off at the end of the two-week period.[5] This is described as a "balloon" payment, and Betty must either make this payment or pay a renewal fee to extend the original loan for another fixed term.[6] The ability to amortize a payday loan through a series of monthly payments is usually not an option under the loan structure.[7] This all-or-nothing requirement for repaying the loan is what sometimes gives rise to the infamous "debt treadmill."[8] Instead of offering amortization, the lender probably would allow Betty to pay a renewal or "rollover" fee to continue the loan for another payment period.[9] Betty might pay this fee simply for the convenience of not having to pay off the loan at the first due date. However, she may extend the loan because she is genuinely unable to repay the balance. Ultimately, Betty

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1. *See* Creola Johnson, *Payday Loans: Shrewd Business of Predatory Lending?*, 87 MINN. L. REV. 1, 9 (2002).

2. *See id.* (citing Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws In Today's Society*, 51 S.C. L. REV. 589, 606 (2000); Daniel A. Edelman, *Payday Loans: Big Interest Rates and Little Regulation*, 11 LOY. CONSUMER L. REV. 174, 174 (1999)).

3. *See id.* at 10 (citing Smith v. Check-N-Go of Illinois, Inc., 200 F.3d 511, 513 (7th Cir. 1999); Drysdale & Keest, *supra* note 2, at 600–01).

4. *See id.* (citing Jean Ann Fox, *What Does It Take to Be Loan Shark in 1998? A Report on the Payday Loan Industry*, *in* 1 CONSUMER FINANCIAL SERVICES LITIGATION 987, 990 (1998)).

5. *See id.* at 59.

6. *See* Karen E. Francis, Note, *Rollover, Rollover: A Behavioral Law and Economics Analysis of the Payday-Loan Industry*, 88 TEX. L. REV. 611, 612 (2010).

7. *See* Johnson, *supra* note 1, at 59.

8. *See id.* at 57–64.

9. *See* Francis, *supra* note 6, at 612.

may only be able to afford a string of these renewals, thus perpetually "rolling over" the loan and never reducing the principal owed. This situation can result in outrageous APRs that often are the subject of critical headlines about the industry.

The fine line between valuable service and predatory "loan sharking" is intriguing because of the unique structure of the payday lending market. Like Betty, many borrowers may not have other readily accessible means of short-term financing. Therefore, the absence of a payday lending industry could leave these sensible borrowers, who truly intend the transaction to be a "one time" deal, without recourse. However, the tendency of payday lenders to prey on borrowers' various misconceptions indicates that an unregulated market is not desirable either.

B. The History of Payday Lending

Attempts to limit and regulate lending practices are as old as the transactions themselves.[10] Indeed, prohibitions on usury[11] are present in the biblical books of Exodus,[12] Leviticus,[13] and Deuteronomy.[14] Unsurprisingly, despite prohibitions on the practice, societies crafted complex lending systems.[15] For example, one historic transaction functioned much like a modern day mortgage, with a landholder temporarily transferring a possessory interest in land in exchange for a lump sum.[16] This mortgage-like transaction, along with other complex schemes for avoiding usury prohibitions, persisted for many years until restrictions ultimately began to ease.[17] Instead of continuing an outright ban, some authorities began allowing lenders to charge for their services and only prohibited "excessive" interest.[18] Regardless, many usury restrictions were simply ignored to begin with.[19] To curtail this, some states opened their courtroom doors, allowing private borrowers to seek recourse against these fringe lenders, with some plaintiffs even managing to win judgments.[20]

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10. *See* Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 969 n.121 (2008).

11. "Historically, [usury was] the lending of money with interest." BLACK'S LAW DICTIONARY 1685 (9th ed. 2009).

12. *See Exodous* 22:25.

13. *See Leviticus* 25:37.

14. *See Deuteronomy* 23:19–20.

15. *See* Spector, *supra* note 10, at 969–70.

16. *See id.* at 970.

17. *See id.*

18. *Id.*

19. *See id.* at 972.

20. *See, e.g.*, Capital Loan Co. v. Bell, 170 S.W. 570, 571 (Ark. 1914) (upholding a decree finding that a certain lending arrangement was usurious); Tolman v. Union Cas. & Sur. Co., 90 Mo. App. 274, 279 (Ct. App. 1901) ("[W]e are clear the present [loan] is tainted with usury and void by force of the statutes."); Cotton v. Barnes, 167 S.W. 756, 757 (Tex. Civ. App. 1914) (affirming a judgment that a loan was usurious).

Despite growing challenges related to these fringe consumer loans, however, payday lending was able to operate "under the radar" of regulators for some time due to its relatively new status.[21] Ultimately, several consumer class action suits filed in state and federal courts brought attention to the industry's problems,[22] and various groups began to petition state legislatures for increased regulation.[23] Currently, the Uniform Consumer Credit Code (UCCC) serves as the model legislation for state regulation of payday lenders.[24]

C. *Effect of Other Law on the Payday Lending Industry*

Aside from the gradual increase in direct oversight of payday lending, a few non-industry-specific provisions arose over the years. For example, unfair trade practices statutes apply if evidence indicates that a lender made misrepresentations to a borrower.[25] In addition, both state and federal legislation concerning debt collection practices apply if money is actually collected by the lenders.[26] Moreover, the Federal Truth in Lending Act (TILA)[27] mandates disclosures regarding the cost of credit at the time of the transaction.[28] Payday lenders initially asserted that they were exempt from these TILA requirements, but in recent years, the industry has recognized its obligation to comply with the statute.[29] Another federal restriction limits the interest rate on loans made to military families,[30] and federal provisions, such as the Equal Credit Opportunity Act,[31] prevent lenders from discriminating based on race, marital status, or

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21. *See* Spector, *supra* note 10, at 975.

22. *See, e.g.*, Pinkett v. Moolah Loan Co., No. 99C2700, 1999 WL 1080596, at *10 (N.D. Ill. Nov. 2, 1999) (certifying a class action suit against payday lenders and holding that a lender must disclose that it holds a security interest in a post-dated check); Hahn v. McKenzie Check Advance of Ill., LLC, 61 F. Supp. 2d 813, 816 (C.D. Ill. 1999) (dismissing class action claims against a defendant lender because the court found that the lender received a security interest in the post-dated check); *Ex parte* Speedee Cash of Ala., Inc., 806 So. 2d 389, 390, 394 (Ala. 2001) (lifting an order staying proceedings in a consumer class action against Alabama payday lenders where the borrowers alleged that the money kept by the lender constituted interest).

23. *See* Spector, *supra* note 10, at 975.

24. *See id.*

25. *See* Odell v. Legal Bucks, LLC, 665 S.E.2d 767, 780 (N.C. Ct. App. 2008); Pa. Dep't of Banking v. NCAS of Del., LLC, 995 A.2d 422, 444 (Pa. Commw. Ct. 2010) (citing 73 PA. CONS. STAT. ANN. § 201-2(4) (West 2008)).

26. *See, e.g.*, 15 U.S.C. §§ 1692, 1692e, 1692f (2006) ("It is the purpose . . . to eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged . . . ."); S.C. CODE ANN. § 37-5-108(2) (2002) ("[I]f . . . a person has engaged in, is engaging in, or is likely to engage in unconscionable conduct in collecting a debt arising from [a consumer credit transaction], the court may grant an injunction.").

27. 15 U.S.C. §§ 1601–1667f (2006 & Supp. III 2009).

28. 15 U.S.C. § 1638(a) (2006).

29. *See id.*; Spector, *supra* note 10, at 979.

30. *See* 10 U.S.C. § 987 (2006).

31. 15 U.S.C. §§ 1691–1691f (2006).

nationality.[32] These peripheral state and federal limitations impose some burdens on the industry, but are minimal compared to many state attempts at regulation.[33]

D. The Economic Impetus for Payday Lending

In an efficient and competitive market, with equally sophisticated and informed buyers and sellers, economic theory dictates that the price of a payday loan (or any good or service) should equal its marginal cost. However, evidence suggests that the industry is not economically efficient,[34] and according to one commentator, a significant reason for this inefficiency is the traditional structure of these transactions.[35]

The typical payday loan is crafted such that the immediate costs (the initial fees) are relatively inexpensive, and the long-term, contingent costs are much more severe.[36] Lenders are generally able to anticipate more certain profits from consumers who continue to renew their loans.[37] Steady fees from the reliable borrowers subsidize newer customers,[38] who typically bring much more uncertainty and risk.[39] In other words, allowing consumers to become repeat borrowers encourages loan growth while reducing risk. Without significant regulation, lenders are able to create an extremely profitable environment. In fact, it has been estimated that lenders receive over ninety percent of their profits from consumers who have five or more rollovers per year.[40] Needless to say, an unbridled market can be dangerous for consumers, but very lucrative for lenders.

Borrowers often fail to recognize the dangers inherent in payday loans because many do not understand their structure and risk.[41] Consumers believe that their loans will be a "one time thing"[42] and that the fee charged is reasonable for that purpose.[43] Lenders build on this "it won't happen to me" perspective by promoting the loans as lasting just until payday and by offering a small "finance charge" rather than a large APR.[44] As a result, borrowers are tempted by the enticing "money now" nature of the transaction and are lulled into ignoring the

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32. § 1691(a), (b).
33. *See supra* Part III.
34. *See id.*; Francis, *supra* note 6, at 631.
35. *See id.* at 631–33.
36. *Id.* at 632.
37. *See id.* (citing Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 44 (2008)).
38. *See* Francis, *supra* note 6, at 632.
39. *See id.*
40. *Id.* at 632 (citing Bar-Gill & Warren, *supra* note 37, at 44).
41. *Id.* at 632–33.
42. *See id.* at 629.
43. *See id.* at 630.
44. *See id.* at 632–33.

significant problems that can arise when payday arrives and they cannot repay the loan.

III. REGULATORY APPROACHES TO PAYDAY LENDING FROM ACROSS THE NATION

States have addressed, both legislatively and judicially, the payday lending industry and its perceived problems. Some states have determined that the optimal solution is prohibition.[45] However, a majority of states allows the industry to function under a system of regulations.[46] Most state oversight schemes place a maximum on the interest rate (or fee) charged or total loan amount and also require lenders to make certain disclosures to borrowers.[47] Some states, however, have taken greater measures to combat the industry's perceived problems. Florida, for example, prohibits rollovers and maintains a statewide database of outstanding payday loans as a means of enforcement.[48] Moreover, Florida guarantees borrowers a sixty-day grace period to repay the loan (free from penalties) and requires credit counseling for individuals who utilize the grace period.[49] Similarly, other states, such as Hawaii and Colorado, prevent lenders from seeking criminal charges against borrowers who present bad checks.[50]

A. Banning the Payday Lending Industry

While most states have at least some degree of regulation over the industry, others have placed more drastic restrictions on the practice, with some banning or refusing to authorize payday lending.[51] For example, North Carolina, which was one of the first states to permit payday lending, allowed its statutes authorizing the industry to sunset, and the practice ceased in 2006.[52] In Arkansas, the judiciary examined the state's payday lending authorization

45. *See, e.g.*, D.C. CODE § 26-319 (LexisNexis 2005 & Supp. 2010); GA. CODE ANN. § 16-17-2 (2007).

46. For a full list of states, see *Payday Lending State Statutes*, NAT'L CONF. OF ST. LEGISLATURES, http://www.ncsl.org/default.aspx?tabid=12473 (last updated Feb. 11, 2011).

47. *See id.*

48. FLA. STAT. ANN. § 560.404(18), (19) (West 2002 & Supp. 2011).

49. *See id.* § 560.404(22)(a), (b)(3).

50. *See* COL. REV. STAT. § 5-3.1-112, -120 (2010); HAW. REV. STAT. ANN. § 480F-6 (LexisNexis 2009).

51. *See supra* note 45 and accompanying text.

52. *See* Spector, *supra* note 10, at 977 (citing N.C. GEN. STAT. ANN. § 53-281 (expired 2001); Press Release, N.C. Att'y Gen. Roy Cooper, Payday Lending on the Way Out in NC (Mar. 1, 2006), *available at* http://www.ncdoj.com/News-and-Alerts/News-Releases-and-Advisories/Press-Releases/Payday-lending-on-the-way-out-in-NC.aspx; *Demise of Payday Lending in North Carolina*, CTR. FOR RESPONSIBLE LENDING, http://www.responsiblelending.org/north-carolina/nc-payday/policy-legislation/archive/NCpayday2006.html (last visited May 11, 2011)).

statutes[53] and found them to be unconstitutional.[54] Moreover, Georgia actually criminalized payday loans,[55] concluding that merely regulating the practice was insufficient.[56]

The rationale behind prohibition is fairly clear. Georgia's statutes, for example, describe payday lending as having "an adverse effect upon military personnel, the elderly, the economically disadvantaged, and other citizens of the State of Georgia."[57] Thus, to combat the problem, the Georgia legislature decided "that substantial criminal and civil penalties" should be available against lenders, and declared the practice "currently illegal."[58] Presumably for Georgia, the struggle to create a fairer payday lending industry was not a battle worth fighting. One can surmise that similar motives were behind North Carolina's decision not to renew the authorizing statutes that permitted the industry in that state.

Arkansas presents a unique situation. The state legislature had enacted the Check-Cashers Act,[59] which allowed payday lending, subject to some restrictions.[60] Despite acknowledging that every legislative act "carrie[d] a strong presumption of constitutionality,"[61] the Supreme Court of Arkansas ultimately found the Act unconstitutional.[62] The court reached this result because of the usury prohibition found in the state's constitution.[63]

While the decision to ban payday lending certainly addresses the industry's issues with blunt force, it is not the ideal solution to a problem that can be resolved without an outright ban. Even the Arkansas Supreme Court acknowledged that its decision would deprive citizens of a service not otherwise available.[64] The reservations of the Arkansas court are not unfounded. A payday loan is a unique transaction, providing some borrowers with a necessary form of credit. Consumers like Betty Borrower who have little savings and no traditional sources of financing may lack other easily accessible means to pay for an unexpected doctor's visit or automobile repair. Yet, problems arise when borrowers enter into transactions unaware of the potential consequences or when lenders are able to trap them in a cycle of debt. Fortunately, it is possible to remedy these problems without banning the industry.

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53. *See* McGhee v. Ark. State Bd. of Collection Agencies, 289 S.W.3d 18, 23–28 (Ark. 2008).

54. *Id.* at 28.

55. *See* GA. CODE ANN. § 16-17-2 (2007).

56. *See id.* § 16-17-1.

57. *Id.*

58. *Id.*

59. ARK. CODE ANN. §§ 23-52-101 to -117 (2000 & Supp. 2007), *declared unconstitutional by McGhee*, 289 S.W.3d 18.

60. *See id.*

61. *McGhee*, 289 S.W.3d at 23–24.

62. *See id.* at 28.

63. *Id.* at 24; *see also* ARK. CONST. art. XIX, § 13.

64. *McGhee*, 289 S.W.3d at 28.

B. Mechanisms for Regulating the Payday Lending Industry

State legislative and regulatory bodies have various mechanisms available to help protect consumers and prevent unconscionable loan agreements. Perhaps the most visible and effective option is limiting the interest rate or fee that a lender can charge. One recent article examined the changed dynamics of payday lending in New Mexico after its state legislature capped lender fees.[65] If Betty Borrower lived in New Mexico before these new regulations (when rates were unrestricted) and wished to take out a payday loan, the resulting annualized interest rate could have approached 2500%.[66] After the state passed the new restrictions, which limited the maximum fee to $15.50 per every $100 loaned,[67] the rate would have decreased around 404%.[68]

Despite the sizeable reduction, this rate still appears quite high for a person of modest means like Betty. However, compared to the fee she would have incurred for "bouncing" a check at her local bank, this rate could be a relative bargain. At Bank of America an overdraft fee is normally $35, and the customer must repay the fee and restore the account to a positive balance within five days to avoid another fee.[69] When analyzed from this perspective, this method of short-term credit (if one could call it that) would result in an APR of 2555% for an overdraft "loan" of $100 repaid on the fifth day.[70] Consequently, when a borrower like Betty truly needs cash, the total annualized interest of one payday loan with a fee cap similar to that of New Mexico's could amount to less than one-fourth the total annualized interest of a bounced check. The difference is noticeable from a dollar cost perspective as well: Betty would pay $35 in fees for

65. Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 578–80 (2010) (discussing the implementation of changes to the New Mexico Small Loan Act of 1955, N.M. STAT ANN. § 58-15-1 to -39 (LexisNexis 2010)).

66. *See id.* at 579–80.

67. § 58-15-33(B). The statute also allows lenders to charge a one-time $0.50 administrative fee for each loan. § 58-15-33(C).

68. *See* Martin, *supra* note 65, at 579–80. For a breakdown of the formula used to calculate the APR of a payday loan, see *How to Calculate the Interest Rate on Payday Loans*, ARKANSANS AGAINST ABUSIVE PAYDAY LENDING, http://www.stoppaydaypredators.org/pdfs2/aaapl_howtocal.pdf (last visited May 11, 2011). Inserting these numbers (a $15.50 fee on a $100 loan that must be repaid in fourteen days) into this formula results in an APR of 404.11%. Including the additional $0.50 administrative fee yields an APR of 417.14%.

69. *See Overdraft & NSF Fees*, BANK OF AM., http://factsaboutfees.bankofamerica.com/manage-banking-fees/overdraft-and-nsf-fees/ (last visited May 11, 2011) (stating that if an account is overdrawn $10 or more, a $35 fee is assessed on the account).

70. The fixed nature of the overdraft fee would result in a lower APR on a higher overdraft amount, with the rate falling to 851.67% for an overdraft of $300. However, because Bank of America charges a fee each time the account is overdrawn, any benefits from a lower APR likely would be more than offset by this crippling loss of flexibility. *See Overdraft & NSF Fees*, *supra* note 69. For example, if Betty needed to pay four different bills of $100 each with overdrafts, she would incur $140 ($35 for each transaction) in fees and face an APR of 2555% if she restored her balance on the fifth day.

an overdraft "loan" of $100 at Bank of America versus only $15.50 for a payday loan of $100 under the New Mexico scheme. Comparing the two options, it becomes evident that a statutory rate cap can greatly limit lender exploitation of borrowers, while also providing borrowers with a more attractive form of short-term financing than a bank overdraft.

A second method of creating a fairer payday lending market involves monitoring outstanding loans to prevent indebted borrowers from repeatedly renewing loans or obtaining multiple loans from multiple lenders. A database to track outstanding payday loans is an important first step in the battle against the debt cycle,[71] and required compliance for lenders helps meet the goal of preventing multiple renewals.[72] Lenders often find loopholes, however, when "renewal" and "rollover" are not adequately defined. In Ohio, for example, lenders circumvented the state's rollover ban[73] by issuing "renewals," which involved charging a fee to extend the life of the initial loan.[74] In Iowa, although lenders may not make more than two outstanding loans to a borrower at one time,[75] they can still create a debt cycle by retiring one loan and merging it into a second loan over and over.[76] Clearly, lenders are adept at exploiting any holes in regulations. Nevertheless, achieving a significant reduction in rollovers is possible. Two scholars suggest that the key components are a database and a mandatory cooling-off period (meaning a borrower must wait a certain amount of time before entering into a new loan).[77] If both of these elements are in place and enforced, these commentators suggest that repetitive borrowing can effectively be eliminated.[78]

Another useful mechanism is to mandate transparency, requiring lenders to make certain disclosures when issuing a payday loan.[79] Although creating a more informed consumer sounds like it could be quite beneficial, generally it has led to rather marginal results in practice. The typical disclosure requirements (such as the APR) arm borrowers with information they do not understand and thus do not use effectively.[80] In addition, human tendencies to believe that "it won't happen to me" prevent borrowers from grasping the perils of failing to

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71. *See* Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 897 (2007).

72. *See id.* at 897–98.

73. *See* OHIO REV. CODE ANN. § 1315.41(E) (LexisNexis 2006) (repealed 2008).

74. *See* Johnson, *supra* note 1, at 67–68.

75. *See* IOWA CODE ANN. § 533D.10(1)(a) (West 2001).

76. *See* Johnson, *supra* note 1, at 66.

77. *See* Mann & Hawkins, *supra* note 71, at 897–98.

78. *See id.*

79. *See* Francis, *supra* note 6, at 626–27.

80. *See* Mann & Hawkins, *supra* note 71, at 903–04 (citing DEAN WILSON, CONSUMER LAW CENTRE VICT. LTD., PAYDAY LENDING IN VICTORIA—A RESEARCH REPORT 77 (2002), *available at* http://www.consumer.vic.gov.au/CA256902000FE154/Lookup/CAV_Credit_Research/$file/payday.pdf; Diane Hellwig, Note, *Exposing the Loansharks in Sheep's Clothing: Why Re-regulating the Consumer Credit Market Makes Economic Sense*, 80 NOTRE DAME L. REV. 1567, 1591–93 (2005)).

quickly repay the loan. The key, therefore, is for states to require disclosures that borrowers can actually understand.[81] A potential way to accomplish this is to force lenders to post the total finance charge in a tangible dollar amount rather than as a more abstract APR.[82]

Finally, perhaps the most essential step that a state can take is to quickly and effectively close any loopholes lenders may attempt to exploit. One author likened payday lenders to the mythical Hydra, noting that each time a governmental entity tries to remove one "head" of the predatory beast, the industry simply sprouts another to replace it.[83] For example, lenders may circumvent many statutes that limit the maximum fee for a loan by using a variety of exotic instruments, such as "sale leaseback" or "cash catalog" transactions.[84] These arrangements basically accomplish the purpose of a payday loan without falling under the exact statutory definition.[85] To combat this, a governmental entity could choose either to prohibit transactions not expressly allowed by law or to place a maximum rate on all short-term loans. Legislatures can also draft decisive statutes that allow little room for creative interpretation about their true meaning, or promulgate broad enabling acts that allow agencies to issue regulations or opinions and address concerns as they arise.

These examples are a few ways that federal and state governments, along with their various regulatory agencies, can help level the playing field between unsophisticated borrowers and powerful lenders. The multitude of available mechanisms demonstrates that the industry is not "beyond repair" or uncontrollable, but rather that a viable and beneficial market can exist if appropriate efforts are made.

IV. THE HISTORY OF PAYDAY LENDING IN SOUTH CAROLINA

The initial legislation promulgated in South Carolina concerning the payday lending industry was the 1998 South Carolina Deferred Presentment Services Act (SCDPSA).[86] The SCDPSA's provisions were specifically tailored for lenders who provided funds to borrowers in exchange for a postdated check[87]—essentially the classic payday loan. Noticeably, banks, other financial institutions, and retail sellers not holding themselves out as a "deferred

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81. *See* Mann & Hawkins, *supra* note 71, at 904–05 (noting that consumers do understand finance charges expressed in dollar amounts and suggesting a modification of disclosure requirements to reflect this).

82. *See id.* at 905.

83. *See* Spector, *supra* note 10, at 962 & n.10 (citing EDITH HAMILTON, MYTHOLOGY: TIMELESS TALES OF GODS AND HEROES 164 (1969)).

84. *See* Johnson, *supra* note 1, at 18–21.

85. *See id.*

86. *See* S.C. CODE ANN. § 34-39-110 to -260 (Supp. 1998).

87. *See id.* § 34-39-120(3).

presentment service" were exempt.[88] Despite the legislature's apparent intent to combat the industry's problems forcefully, however, the initial provisions in the Act were not as effective as intended. Its primary components were an annual licensing requirement for all payday lenders[89] and a disclosure requirement about the fees charged by the lenders, including the APR.[90] Also, fees could not exceed 15% of the loan amount, and the maximum time period for deferred presentment loans was thirty-one days.[91] Lenders were further prohibited from allowing borrowers to renew or rollover loans by immediately undertaking another deferred presentment loan.[92] If a borrower's check did not clear, the lender could resort to mechanisms of civil recourse, including the imposition of a returned check fee, but they could not seek criminal prosecution of the borrower.[93] Finally, deferred presentment lenders were prohibited from engaging in other lending activities.[94]

Despite what appeared to be an in-depth regulatory scheme, however, the General Assembly seemingly felt that the SCDPSA was inadequate. The legislature's displeasure with the law manifested itself in 2009 with amendments to the Act. These amendments were designed to place tougher restrictions on what one lawmaker characterized as "a rogue industry . . . that does not care about the citizens of South Carolina."[95] The new statutes limit the dollar amount of loans to $550[96] and create a database to ensure that borrowers can only have one loan outstanding at a time.[97] The purpose of this centralized database is to provide comprehensive restrictions on the availability and amount of loans made to borrowers who already have a loan in their name.[98] The Consumer Finance Division of the Board of Financial Institutions oversees the new database, while an independent authority operates it.[99] Under this current regime, if Betty Borrower seeks to take out a payday loan, the lender must consult the database to determine whether she has any outstanding loans before declaring her eligible,[100] greatly reducing the possibility of her being caught in cycle of debt.

The amended SCDPSA also requires lenders to offer extended payment plans for qualified borrowers.[101] If unable to repay a loan when due, a borrower may elect once every twelve months to request an extended payment plan, under

88. § 34-39-140.
89. §§ 34-39-130, -150(D).
90. § 34-39-180(C), (D).
91. § 34-39-180(A), (E).
92. § 34-39-180(F).
93. § 34-39-180(G).
94. § 34-39-200(2).
95. *See* Roddie Burris, *S.C. Senate Closes Payday Lending Loophole*, THE STATE (Apr. 16, 2010), http://www.thestate.com/2010/04/16/1246068/sc-senate-closes-payday-lending.html.
96. S.C. CODE ANN. § 34-39-180(B) (Supp. 2010).
97. *See* S.C. CODE ANN. §§ 34-39-175(A), -270(A) (2010).
98. *See id.* § 34-39-175(B).
99. *See id.* § 34-39-175(A).
100. *See id.* § 34-39-175(B).
101. S.C. CODE ANN. § 34-39-280 (Supp. 2010).

which the borrower makes at least four "substantially equal" payments, coinciding with the borrower's payday.[102] The amendments also prohibit lenders from charging returned check fees for borrowers' checks that do not clear.[103] These provisions demonstrate an attempt by the General Assembly to further curtail predatory practices and protect borrowers from exploitation.

Nonetheless, as the saying goes, "[t]he best-laid schemes o'mice and men [often go awry],"[104] and the 2009 amendments to the SCDPSA were no exception. An unanticipated loophole allowed lenders to become licensed as supervised lenders and be governed by another set of rules.[105] In fact, 99 of the 245 companies who discontinued their payday lending licenses in 2009 requested to be reclassified as supervised lenders in order to avoid the tougher restrictions.[106] In response, lawmakers introduced yet another bill, which modified the criteria of supervised loans.[107] The bill amends the definition of a supervised loan to include a credit arrangement of at least 120 days.[108] In addition, the bill provides that postdated checks can no longer secure supervised loans.[109]

If passed, the bill should close the loophole left after the 2009 modifications and prevent lenders from continuing their traditional payday lending businesses under the more sheltered supervised lender moniker.[110] It is important to note, however, that although this bill prevents supervised lenders from making payday loans, it does not prevent payday lenders from dropping their licenses and originating instruments that do not meet the definition of a supervised or payday loan.

In contrast to the ongoing saga between lenders and the General Assembly, the judiciary has had little interaction with the payday lending industry. The most newsworthy development involving the courts concerned a recent settlement between several lenders and a class of consumers who filed suit in 2007.[111] Although the settlement still needs approval and finalization, the defendant lenders have agreed to pay borrowers $2.5 million for various

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102. *See id.* § 34-39-280(A), (C).

103. *See id.* § 34-39-180(G).

104. Robert Burns, To a Mouse (1785), *reprinted in* GEORGE SCOTT WILKIE, SELECT WORKS OF ROBERT BURNS: VERSE, EXPLANATION AND GLOSSARY 3 (1999).

105. *See* S.C. CODE ANN. §§ 37-3-500 to -515 (2002) (Supp. 2010).

106. *See* Page Ivey, *Payday Lenders Adjust to SC Law Change*, THE STATE (Dec. 24, 2010), http://www.thestate.com/2010/12/24/1618423/payday-lenders-adjust-to-sc-law.html#disqus_thread.

107. S. 1065, 118th Gen. Assemb., Reg. Sess. (S.C. 2010).

108. *See id.*

109. *See id.*

110. *See* Burris, *supra* note 95 ("Lawmakers became alarmed when more than 100 payday lenders changed their business licenses to become supervised lenders. Legislators feared the lenders were trying to escape regulation while continuing to operate as payday lenders.").

111. *See* Order Preliminarily Approving Class Settlement at 1, *In re* Pay Day Lending & Title Loan Litig., No. 07-CP-40-07710 (Richland, S.C., Ct. Common Pleas June 3, 2010), *available at* http://www.scpaydayclaimsettlement.net/downloads/FiledOrder.pdf; Roddie Burris, *$2.5 Million Settlement Reached for Payday Loans*, THE STATE (Columbia, S.C.), Aug. 13, 2010, at A1.

transactions executed before the comprehensive legislation passed in 2009.[112] While the lenders maintain they did not break any laws,[113] their choice to settle rather than litigate is notable.

V. STRENGTHENING THE SHARK TANK: RECOMMENDATIONS FOR SOUTH CAROLINA'S REGULATION OF THE PAYDAY LENDING INDUSTRY

The various mechanisms available to South Carolina demonstrate that payday lending does not deserve an outright ban. In pursuing instead the regulatory approach, the General Assembly may wish to give certain state agencies greater control in overseeing the payday lending industry. An enabling act that provides an agency, such as the State Board of Financial Institutions, with greater discretion in promulgating rules, regulations, and advisory opinions could eliminate loopholes and uncertainty about statutory definitions or proper methods of compliance. The legislative process is inherently time-consuming, and it is often difficult to build a consensus around even the most noble of causes. With greater authority, a regulatory agency could shorten the lengthy legislative process and quickly address unforeseen issues. The administrative agencies directly overseeing the industry would presumably have deeper insights into concerns about the industry, and the need for quick action makes them ideal candidates for enhanced regulatory ability.

If increased agency discretion is not feasible, the legislature should consider passing an act that uniformly regulates all short-term consumer loans. A consistent statutory maximum rate or fee for all short-term loans could help eliminate much of the gray area present in the fringe banking industry. This would prevent lenders from crafting new instruments seeking to avoid oversight because every consumer loan would be subject to these rules, no matter the structure. Additionally, the burden would be placed on lenders to comply, rather than on the state to take action post hoc.

VI. CONCLUSION

The future of the American payday lending industry remains highly uncertain. Many of the developing trends and proposals may need national oversight rather than the current patchwork of state regulations. In fact, some recent commentators focusing on the industry conclude that a national, uniform effort is the only adequate way to prevent exploitation of loopholes in the current system.[114] A national framework may be the only way to ensure complete

112. *See* Burris, *supra* note 111, at A1.

113. *See id.*

114. *See* Charles A. Bruch, Comment, *Taking the Pay Out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders*, 69 U. CIN. L. REV. 1257, 1285 (2001) ("To stem this momentum [of the payday loan industry], and to prevent the payday loan industry from becoming indelibly entrenched in American society, Congress needs to

protection of all of the nation's consumers because some states are less strict in their oversight of payday lenders than others. Despite this, states still have the power to ensure that their legislation is clear, and that lenders comply with specific rules.[115] By enacting strong legislation, states can reduce the ability of lenders to avoid oversight, and if nothing else, help prevent exploitation of their citizens.

Therefore, notwithstanding the uncertain future of the industry, South Carolina has enough options at its disposal to ensure that payday lending remains available and fair to its citizens. Fringe banking businesses garner much attention from the media and consumer advocates. However, without these lenders, many borrowers may not have other legal options for short-term financing. Strict regulation can ensure that a viable fringe banking industry exists without the exploitation of borrowers. Legislative and regulatory scrutiny, along with quick action when needed, will ensure that sufficient oversight occurs and that lenders adhere to appropriate rules. Ultimately, a well-regulated, accessible, and legal payday lending industry will best protect consumers both from the neighborhood "loan shark" and from the shark in a nearby storefront.

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act quickly."); Johnson, *supra* note 1, at 147 ("[T]he federal government must act now to enact comprehensive regulations dealing with the payday lending industry.").

115. *See* Spector, *supra* note 10, at 996.

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